MEMORANDUM OF LAW

DATE: October 15, 1992

TO: Conny Jamison, City Treasurer

FROM: City Attorney

SUBJECT: Proposed Council Policy Regarding Business Tax Certificates

This replies to your memorandum of July 8, 1992, concerning a proposed Council Policy respecting the City business tax. You summarize the proposed Council Policy as a regulation that the City will not provide service to, or enter into any contract with, any business entity which does not have a current business tax certificate. You have asked whether there may exist any valid legal objections to such a policy. We conclude there is a legal infirmity in the proposal to withhold services to gain compliance, but the proposal requiring City contractors, service providers, and vendors to have a tax certificate is sound so long as the tax is not discriminatory and is fairly apportioned. We reason as follows:

A. Authority to Impose Tax

The authority of the City of San Diego to impose a tax is vested in its freeholder's charter. Section 1 of the San Diego City Charter ("Charter") establishes the City's general and plenary corporate powers, and as is relevant to this discussion, provides in part:

> ┌The City of San Diegoσ generally shall have all municipal powers, functions, rights, privileges and immunities of every name and nature whatsoever now or hereafter authorized to be granted to municipal corporations by the Constitution and laws of the State of California.

Section 2 of the Charter next sets forth the City's powers under the Constitution and General Laws:

> The City of San Diego, in addition to any of the powers now

> held by or that may hereafter be granted to it under the Constitution or Laws of this State, shall have the right and power to make and enforce all laws and regulations in respect to municipal affairs, subject only to the restrictions and limitations provided in this Charter; provided, however, that nothing herein shall be construed to prevent or restrict the City from exercising, or consenting to, and the City is hereby authorized to exercise any and all rights, powers and privileges heretofore or hereafter granted or prescribed by General Laws of the State.

Said Charter provisions were adopted pursuant to authority afforded to cities by the California Constitution, formerly Article 11, Section 8, and now embodied in Article 11, Section 5, subdivision (a). That authority states:

> Section 5. City charters; provisions
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> Sec. 5. (a) It shall be competent in any city charter to provide that the city governed thereunder may make and enforce all ordinances and regulations in respect to municipal affairs, subject only to restrictions and limitations provided in their several charters and in respect to other matters they shall be subject to general laws. City charters adopted pursuant to this Constitution shall supersede any existing charter, and with respect to municipal affairs shall supersede all laws inconsistent therewith. (Emphasis added.)

This authority is commonly referred to as the "home rule" or "municipal affairs" power, and allows chartered cities to enact policies and ordinances respecting their own local affairs. The raising of revenue through taxation has been held to be within such power. A charter city, under its powers over local affairs to raise revenue, can impose a proper nondiscriminatory license tax. Ex Parte Braun, 141 Cal 204, 213 (1903); West Coast Adver. Co. v. San Francisco, 14 Cal. 2d 516, 524 (1939); Security

Truck Line v. City of Monterey, 117 Cal. App. 2d 441, 450-451 (1953).

However, exactions for regulation must be distinguished from exactions for revenue purposes. If the tax is levied for purposes of regulation, and a certain business is already regulated by the state, the local regulation will be preempted. Municipal regulatory licensing legislation in conflict with state law is void unless state law specifically provides that the local law should prevail in the City. Verner, Hilby, & Dunn v. City of Monte Sereno, 245 Cal. App. 2d 29, 33-34 (1966). On the other hand, a municipal licensing ordinance of a charter city intended for revenue purposes only is not inconsistent with a state statute imposing regulations on the same subject matter. Rivera v. City of Fresno, 6 Cal. 3d 132, 135-137 (1971); Willingham Bus Lines, Inc. v. San Diego Municipal Court, 66 Cal. 2d 893, 895-896 (1967); In re Groves, 54 Cal. 2d 154, 157-158 (1960).

The San Diego City Council has enacted a business tax according to the above described provisions of the Charter and Constitution. That business tax ordinance is found in San Diego Municipal Code ("SDMC") sections 31.0101 et seq. The initial sentence of section 31.0101 provides that "[t]here is hereby imposed a business tax which, under the provisions of this Article, is enacted solely to raise revenue for municipal purposes and is not intended for the purpose of regulation." (Emphasis added.) This preamble assures that the revenue tax remains within the sphere of municipal affairs, and consequently the tax is lawful if fairly apportioned.

B. Application of Proposed Council Policy

The next consideration, then, is whether the foregoing conclusion would in any way be changed if the proposed Council Policy were adopted and implemented. It is noted that the proposed policy has two distinct components: a) that the City will not provide services to a local business which does not have a current business tax certificate; and, b) that the City will not contract (either for goods, services, or public work) with any business unless it has a current business tax certificate. These two components should be analyzed separately.

1. Refusal to Provide City Services

The first element, refusal to provide City services, presents a certain legal complication. This approach to the problem would attempt to obtain compliance by penalizing violators through the withholding of City services, apparently regardless of whether the violating business is attempting to contract with the City. This proposed enforcement method is not consistent with provisions of the existing ordinance relating to

enforcement. SDMC section 31.0128 provides that any person who is required to have a business tax certificate but fails to display it upon request of an authorized City agent is guilty of a misdemeanor. In this avenue of enforcement, proof of the violation would have to be made beyond reasonable doubt in a criminal court. In addition to the criminal remedy, SDMC section 31.0131 provides additional bases for sanction. These include penalties in the nature of fines, or grounds for "filing of a complaint against the person or persons responsible for paying the taxes . . . ." Such a complaint would be for a debt owed to the City, and would require the filing of a civil suit pursuant to the express authority of SDMC section 31.0122. The point is, the enforcement ordinances do not provide for administrative relief, only judicial relief. Therefore, we do not believe that the withholding of City services would be a lawful remedy unless judicially ordered. Moreover, the withholding of essential services such as police or fire protection could have far-reaching consequences. We thus advise that the proposed Council Policy must be consistent with the existing enforcement provisions of the Municipal Code, and refusal of service is not a facet of those provisions. An amendment to the present enforcement provisions would be necessary to allow administrative remedies, and this would entail further considerations not made here regarding due process requirements and potential exposure to liability.

2. Requirement of Certificate From All Doing Business With City

The second element of the proposed policy, to require that City contractors obtain the tax certificate, would not be problematic if certain conditions relating to fair apportionment are met. SDMC section 31.0121 provides that " ┌nσo person shall engage in any business, trade, calling or occupation required to be taxed under the provisions of this Article until a certificate of payment is obtained." The term "engaged in business" is defined broadly in SDMC section 31.0110(d), and without full quotation here, that definition appears to cover any enterprise transacting or furnishing services or property. An exception to this tax is allowed by SDMC section 31.0202, which limits the definition of "doing business" to only those businesses engaged in taxable activity for seven or more days per year. Since doing business with the City for seven or more days is doing business in the City, in that some goods or services are provided to the City, we believe that the tax applies to all with whom the City does business for that minimum time. Providing goods and services to the City is doing business in

the City, taxable events occur as such, and the City is thus empowered to tax these events by a proper nondiscriminatory ordinance. Security Truck Line v. Monterey, 117 Cal. App. 2d at 442; City of Los Angeles v. Shell Oil Co., 4 Cal. 3d 108, 122 (1971).

The law is established that in order for the tax to be proper and nondiscriminatory, it must be rationally based on the quantum of business actually done in the City. Security Truck Line, 117 Cal. App. 2d at 454. The California Supreme Court held in Los Angeles v. Shell Oil Co.:

> It is clear that in spite of the absence of a specific "commerce clause" in our state Constitution, other provisions in that Constitution -- notably those provisions forbidding extraterritorial application of laws and guaranteeing equal protection of the laws ┌Article XI, section 11 (now section 5); Article I, section 21σ -- combine with the equal protection clause of the federal Constitution to proscribe local taxes which operate to unfairly discriminate against intercity businesses by subjecting such businesses to a measure of taxation which is not fairly apportioned to the quantum of business actually done in the taxing jurisdiction.
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> On the other hand those constitutional principles do not prohibit local license taxes upon businesses "doing business" both within and outside the taxing jurisdiction; as long as such taxes are apportioned in a manner by which the measure of tax fairly reflects that proportion of the taxed activity which is actually carried on in the taxing jurisdiction, no constitutional objection appears.

Id., 108 Cal. 3d at 124 ┌emphasis in originalσ

For other articulations of these principles, see also: General Motors v. City of Los Angeles, 5 Cal. 3d 229, 238-239 (1971); Ferran v. City of Palo Alto, 50 Cal. App. 2d 374, 381-384

(1942); In re Application of Smith, 33 Cal. App. 161, 162-164 (1917).

We are satisfied that the City's business tax is fairly apportioned with respect to intercity business. SDMC section 31.0301 provides for a flat annual business tax of $125.00 per each business located in the City, plus an additional $5.00 per employee. For businesses located outside the City but which hire agents, representatives, or independent contractors in the City (and whose activities in the City exceed the six day limitation of exemption), an election is provided by SDMC section 31.0301 to pay the flat $125.00 fee plus an additional $5.00 for each independent contractor, agent, or representative working in San Diego. Hence, businesses located outside the City and doing business with and in the City for more than six days will have the option of either being taxed under the same scheme as City located businesses, or may pay the flat fee of $125.00 for the privilege plus $5.00 for each of its local agents. Clearly, the $5.00 assessment for the activities of local agents in the City bears a rational relationship to the quantum of business an intercity business does in the City. And although in instances of small transactions with intercity businesses the $125.00 base fee could possibly be contested on grounds of faulty apportionment, this situation seems unlikely given the six day threshold for application of the tax and the relative inexpense of $125.00 for activities which surpass that limitation. The present tax could therefore likely be successfully defended against claims of unfair apportionment.

CONCLUSION

The element of the proposed Council Policy respecting the withholding of services would be arguably unlawful due to inconsistency with existing enforcement provisions. The element of the proposed policy that would require those who do business with the City to obtain a tax certificate presents no legal difficulty given the apportionment provisions of the present Municipal Code ordinances respecting businesses located outside the City.

JOHN W. WITT, City Attorney
By
Frederick M. Ortlieb
Deputy City Attorney

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